United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

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UNITED STATES COURT OF APPEALS

for the

SECOND CIRCUIT

FRANK J. CRIMMINS,

Plaintiff-Appellant,

-against-

AMERICAN STOCK EXCHANGE, INC.,

Defendant-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF PLAINTIFF-APPELLANT
FRANK J. CRIMMINS

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Docket No. 1289/74

FRANK J. CRIMMINS,

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ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF PLAINTIFF-APPELLANT FRANK J. CRIMMINS

Preliminary Statement

This is an Appeal, pursuant to 28 U.S.C. § 1291, by Plaintiff-Appellant, Frank J. Crimmins ("Crimmins") from the opinion, order and judgment ("Opinion") of the United States District Court for the Southern District of New York (Lasker, J.) dated December 12, 1973, denying Crimmins' motion for summary judgment and granting the cross-motion of Defendant-Appellee American Stock Exchange, Inc. ("Exchange") for summary judgment, Crimmins v. American

Stock Exchange, Inc., 368 F. Supp. 270 (S.D.N.Y. 1973). The Opinion denied Crimmins' application to vacate and enjoin enforcement of the determination ("Panel Determination") of an Exchange disciplinary panel ("Panel") suspending Crimmins from any employment with any member firm for a period of nine months and from supervisory employment for a period of two years.

STATEMENT OF ISSUES

The issues presented by this Appeal are as follows:

1. Did the District Court err in applying an overly restrictive standard for judicial review of stock exchange disciplinary proceedings?

2. Did the Exchange deny due process to Crimmins by failing to give him fair and adequate notice of the nature and basis of Charge 1 and by hearing charges which were not in its notice? The District Court answered this question in the negative (Opinion, 177a*).

3. Did the Exchange violate due process by imposing a penalty for Charge 1, since Charge 1 was based on a standard of conduct which was unconstitutionally vague as applied to the facts of this case? The District Court answered this question in the negative (178a).

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* References to documents contained in the Appendix of this Appeal are indicated by "a" following the page number of the Appendix.

4. Did the Exchange violate due process by imposing a penalty based on a finding, not supported in the record, that Crimmins had made a "misstatement of material fact"? The District Court answered this question in the negative (188a).

5. Did the Exchange err as a matter of law in finding that Crimmins had violated Regulation T (12 C.F.R. § 220.7(a))? The District Court answered this question in the negative (179a-188a).

6. Did the Exchange violate due process by imposing an unreasonably severe and punitive penalty under the facts of this case without any finding or evidence that such a penalty was required by the public interest? The District Court answered this question in the negative (188a-189a).

Statement of the Case

Crimmins was a registered representative of Walston & Co., Inc. ("Walston"), a registered broker-dealer and member firm of the Exchange, from 1965 until December 20, 1972, when he resigned (Affidavit of Frank J. Crimmins dated September 7, 1973, ¶ 5). During the latter part of that period, Crimmins was also one of over 100 Walston branch managers and a vice president and 1% stockholder of Walston (Id.). Crimmins was in the brokerage part of the business and had no executive or policy making responsibility (Id.).

Walston became a financial advisor to Four Seasons Nursing Centers of America, Inc. ("FSN") some time in 1967; managed public offerings of securities of FSN or its affiliates in 1968 and 1969; and, as a firm, recommended the purchase and sale of FSN securities to brokerage customers (7a-10a, 13a). Walston created a limited partnership, Montgomery & Co., as an investment vehicle for Walston's officer-stockholders, and Montgomery bought restricted shares of FSN in 1967 (Tr. 303)*. Crimmins was a 2% limited partner of Montgomery, but had no voice in its investment decisions (Tr. 306). At Montgomery's inception, Walston arranged for a New York bank to extend credit to limited partners in connection with raising the funds for Montgomery to purchase the FSN restricted stock (Tr. 303). FSN common stock was listed on the Exchange in November 1968 and trading was stopped in April 1970 (5a, 6a).

Crimmins had contacts with FSN management, all of which were known and approved by Walston's responsible officers, and which are discussed below. In late 1968, Montgomery sold half of its restricted FSN stock, including Crimmins' pro rata portion (Tr. 305). This sale was made over Crimmins' objection, and resulted in Crimmins personally buying restricted FSN stock from FSN officers (Tr. 305-06). This purchase was

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* References to the transcript of the hearing before the Panel, Exhibit A to the affidavit of Thomas W. Hill, Jr., dated September 7, 1973 ("Hill Affidavit"), are designated as "Tr." preceding the relevant page numbers. Relevant portions of the transcript are assembled as an exhibit to the Appendix of this Appeal.

made on cash and credit, and ultimately resulted in a loss to Crimmins of $405,000 (Tr. 307-09). Walston's house counsel testified there was nothing wrong with Crimmins' purchase (Tr. 285-86) and its compliance director testified that Regulation T, 12 C.F.R. § 220.7(a), was not applicable to the transaction (Tr. 317-18). Although this testimony was not essentially contradicted, this stock purchase, together with the management contacts referred to above, were the primary bases for the sanction imposed below.

In November 1971, the Exchange issued a statement containing three charges ("Charges") against Crimmins (91a-98a) alleging that, as an employee of a member firm, he had violated Exchange rules "in the pattern of circumstances" described in a Report of Investigation ("Report") previously served upon him (5a-80a).

Charge 1 of the Charges conflicts with the Report and fails to give Crimmins fair and adequate notice of what is alleged and why it is wrongful. It states that Crimmins "was in a position to obtain" inside information about FSN as a result of a so-called "special relationship" allegedly maintained between Walston, his employer, and FSN. As a result, he was charged with "conduct or proceeding inconsistent with just and equitable principles of trade" in recommending FSN stock to brokerage customers. However, the Report (which is incorporated by reference and made a part of the Charges) alleges actual possession and use of

inside information regarding FSN* (Report, 26a-27a, 39a, 42a-46a, 66a-67a, 70a).

The Report fails to contain a clear statement of what standard of conduct constitutes a violation of "just and equitable principles of trade" and which of the many "circumstances" in the 76 page Report violate that standard. There is no distinction made between "background" facts and those which the Exchange claimed were necessary elements of the charge of misconduct. Crimmins was unable to determine which explicit or inferential allegations would require defenses.

He attempted to obtain answers to his questions by serving the Exchange with interrogatories ("Interrogatories") (99a-114a), but the Exchange refused to supply any answers, thereby <u>compounding</u> the lack of fair notice with lack of discovery.

At the hearing before the Panel, over objection by Crimmins' counsel, the Exchange alleged at least six new charges not contained in its notice. These are detailed at pp. 18-23 *infra*. Crimmins was forced to defend

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* The Report attempts to prove such use by means of trading statistics which Walston had shown to be grossly in error (83a-90a and pp. 47-50 of Exhibit E to Affidavit of Thomas W. Hill, Jr. dated September 7, 1973) and which the Exchange later admitted to be in error (but not until the Panel hearing was in progress, Tr. 91).

himself against the new charges without preparation; to some extent he was unable to do so. As a direct result, (1) one of the new charges is included in the Panel Determination*, (2) the Panel was prejudiced in favor of a finding of guilt and (3) the Panel imposed an unconscionable penalty.

The Panel Determination (129a-132a) found Crimmins guilty on Charges 1, 2(i)** and 3 and suspended him from any employment by a member firm for nine months and from employment in a supervisory capacity for two years. It is uncontroverted that this penalty is so harsh it would have the effect of expelling Crimmins from the securities business. (See Affidavit of Frank J. Crimmins dated September 7, 1973). Indeed, all of the facts on which this appeal is based are undisputed by the Exchange.

Crimmins sought to enjoin enforcement of the Panel Determination and moved for summary judgment in the District Court. The District Court denied Crimmins' motion, granted summary judgment to the Exchange and dismissed the complaint.

As will be shown, _infra_, the District Court did

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* The Determination finds (130a) that Crimmins breached a duty of disclosure.

** The Panel found for Crimmins on Charge 2(ii); i.e., his private FSN purchases did not violate the Exchange's Rule prohibiting off-the-floor trading in listed stocks.

not apply the proper standard in reviewing the Exchange's conduct (Point I, infra); the notice given Crimmins did not comply with due process standards of specificity and the Panel's consideration of charges not contained in the Exchange's notice violated due process (Point II, infra); the Panel applied a standard vague and undefined under the facts of this case in weighing Crimmins' conduct (Point III, infra); the Panel and the District Court erred in finding that the record supported the imposition of a penalty on Charge 2 (Point IV, infra), in finding that Regulation T was violated (Point V, infra), and in sustaining a penalty which violated due process in that it was not based on the public interest, was unjustifiably severe and ignored mitigating factors required to be considered as a matter of law (Point VI, infra).

Relief Sought

Crimmins requests that the decision of the District Court be reversed and summary judgment be entered in his favor, vacating the Panel Determination and dismissing the Charges.

ARGUMENT

I

THE DISTRICT COURT ERRED BY APPLYING AN OVERLY RESTRICTIVE STANDARD FOR JUDICIAL REVIEW OF STOCK EXCHANGE DISCIPLINARY PROCEEDINGS.

The District Court, by the standard of review it espoused, effectively denied judicial review of any individual seeking to challenge the result of so-called "intra-professional disciplinary proceedings" (Opinion, 190a). Judge MacMahon has previously held in this action that proceedings before the Panel were "governmental action, federal in character", to which due process applied. Crimmins v. American Stock Exchange, Inc., 346 F. Supp. 1256, 1259 (S.D.N.Y. 1972). Judge Lasker, however, substantially obviates this due process requirement by articulating the following standard of judicial review:

> "... we strongly disapprove of resort to the courts in such matters, except, perhaps, in cases of clearly arbitrary or unjust professional determinations ..." (emphasis added) (190a)

Attorneys are instructed, as a matter of professional responsibility, to seek judicial review of disciplinary proceedings only when they are "convinced beyond professional doubt" that an individual "has been denied the relevant elements of fairness" by the disciplinary body (191a). Great deference is accorded to the determinations

of "a panel of plaintiff's professional colleagues, better situated than this Court to assess a fair penalty", to which the District Court freely attributed its own "sense of fairness, regard for standards of conduct, attention to ethics and attention to the facts" (189a, 190a).

Neither the Securities and Exchange Commission ("SEC") nor the courts have previously given such conclusive weight to "the reasoned consideration of the responsible professional administrative tribunals themselves" (190a).* The SEC has consistently overridden or reduced penalties imposed by panels of the National Association of Securities Dealers ("NASD"), which are composed of plaintiff's "professional colleagues". See, *e.g.*, *Anthony J. Amato*, SEC 1934 Act Rel. No. 10265, June 29, 1973; *Allessandrini & Co., Inc.*, SEC 1934 Act Rel. No. 10313, Aug. 1, 1973; *Adolph D. Silverman*, SEC 1934 Act Rel. No. 10327, Aug. 6, 1973. Penalties imposed by panels of national stock exchanges are not presently subject to SEC review, but the SEC, recognizing that such panels of "professional colleagues" often do not perform fairly, has explicitly requested power:

> "...to review all disciplinary actions taken by self-regulatory organizations ... [including] power to affirm, dismiss or modify any penalties ... [as] necessary

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* No reasons are given by the Exchange panel, for example, for the finding that plaintiff violated Regulation T (see Point V, *infra*) or why such a severe penalty is necessary, appropriate or in the public interest (see Point VI, *infra*).

or appropriate in the public interest and to insure the fair administration of discipline by the self-regulatory organizations." SEC Study of Unsafe and Unsound Practices of Brokers and Dealers (Dec. 1971), ch. 1, p. 42.

It is the law of this case that the Exchange is subject to the fairness requirements of due process. Crimmins v. American Stock Exchange, Inc., supra. It is a long and unwarranted backward leap from the imposition of this requirement on the Exchange to the District Court's standard for reviewing compliance with the requirement: abdication of review over all but "perhaps" the most flagrant abuses of due process committed by the "private club" (190a). In reaching this result, the District Court erroneously deferred to the nonexistent constitutional expertise of the colleagues of an employee of an Exchange member in their denial of due process to all such employees, apparently in order to save the Court's time and to insure "finality" in "intra-professional disciplinary proceedings" (190a).*

The District Court appears to have confused two separate criteria of review: substantial evidence and constitutional scrutiny. Deference to the expertise of an administrative agency under the substantial evidence standard

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* Judge Lasker reaches this result by analogy to bar association proceedings (190a). However, disbarment proceedings normally require court trials, with all the constitutional, discovery and procedural rights attendant thereto. In re Kahn, 38 A.D.2d 115, 328 N.Y.S.2d 87 (1st Dept. 1972), aff'd 31 N.Y.2d 752 (1972); N.Y. Judiciary Law, § 90(2), (6), (8).

is commendable when facts within the area of the agency's expertise are found. But when violations of due process by an administrative disciplinary body are charged, as they are here, federal courts are required to make their own _de novo_ examination of the facts in the record, using their _own_ constitutional expertise to assure compliance with fundamental fairness. _Jaffee & Co._ v. _SEC_, 446 F.2d 387, 392-94 (2d Cir. 1971); _Intercontinental Industries, Inc._ v. _American Stock Exchange_, 452 F.2d 935, 940-43 (5th Cir. 1971), _cert. denied_, 409 U.S. 842 (1972); _Robert W. Stark, Jr., Inc._ v. _New York Stock Exchange, Inc._, 346 F. Supp. 217, 232 (S.D.N.Y. 1972), _aff'd_, 466 F.2d 743 (2d Cir. 1972); _Bright_ v. _Philadelphia-Baltimore-Washington Stock Exchange_, 327 F. Supp. 495, 505 (E.D. Pa. 1971). There is no administrative expertise to which the Court may refer under the latter standard; it alone must judge the protection of the Constitution. _See_ Administrative Procedure Act, § 10(e)(B)(2), 5 U.S.C. § 706(e)(2)(B) and _Beck_ v. _SEC_, 413 F.2d 832 (6th Cir. 1969). It was this _de novo_ review of the record -- a search for due process, not for substantial evidence to support a factual finding -- that the District Court erroneously refused to make.

II

THE EXCHANGE DENIED CRIMMINS DUE PROCESS BY FAILING TO GIVE HIM FAIR AND ADEQUATE NOTICE OF THE NATURE AND BASIS OF CHARGE 1 AND BY HEARING CHARGES WHICH WERE NOT IN ITS NOTICE.

Fair Notice Requirements

The Exchange has not disputed the applicability of federal due process requirements to its disciplinary proceedings; Silver v. New York Stock Exchange, 373 U.S. 341 (1963); Intercontinental Industries, Inc. v. American Stock Exchange, supra; Crimmins v. American Stock Exchange, Inc., supra, 346 F. Supp. 1256, 1259.

Due process requires that before commencement of an administrative proceeding in which an individual's right to employment is at stake, there must be fair notice of the charges to be heard; Re Ruffalo, 390 U.S. 544, 551 (1968).

"Fair notice" requires that the agency advise the accused of the claim against him and the grounds upon which it rests. Conley v. Gibson, 355 U.S. 41, 47 (1957); Morgan v. United States, 304 U.S. 1, 18 (1938). The notice may not be ambiguous, veiled or indistinct, Jaffee & Co. v. SEC, supra; Brandt v. Hickel, 427 F.2d 53 (9th Cir. 1970); it must clearly define the issues and advise of the specific complaint, J.C. Penney Co. v. N.L.R.B.,

384 F.2d 479, 483 (10th Cir. 1967). When an important element of due process, such as notice, is rendered so as to make it subject to multiple constructions, due process is denied, Jaffee & Co. v. SEC, supra; Brandt v. Hickel, supra. Faulty notice is not excused by speculation that the defense would not have been different if proper notice had been given, Northeastern Indiana Building & Const. Tr. Coun. v. N.L.R.B., 352 F.2d 696, 699 (D.C. Cir. 1965).

In Jaffee & Co., supra, the order for proceedings could be construed to state both active and derivative liability under Section 15(b)(5) of the 1934 Act. When the Securities and Exchange Commission imposed a sanction, after a hearing, based on derivative liability, this Court reversed on the grounds that the notice given respondent was inadequate, stating that:

> "[A] Primary purpose of the notice requirement in this case is to permit the respondent a reasonable opportunity to prepare a defense against the theory of liability invoked by those who institute the proceedings against it. A respondent may not reasonably be expected to defend itself against every theory of liability or punishment that might theoretically be extrapolated from a complaint or order if one were to explore every permutation of fact and law there alluded to or asserted....
>
> "Thus, for the hearing requirement to have any meaning, the notice provision must be interpreted to require that respondent have 'fair notice' of the claim lodged against it 'and the grounds upon which it rests,' .... [T]he order instituting these

> proceedings was patently inadequate to disclose that it [Jaffee & Co.] would ultimately be required to fight a two-front war." 446 F.2d at 394 (citation omitted).

Fair notice also means that additional charges, not set forth in the notice, may not be introduced during the hearing. In <u>Re Ruffalo</u>, <u>supra</u>, an attorney's disbarment from practice in a federal court was held to be in violation of due process, because one of the grounds for disbarment was added, without prior notice, after the attorney had testified in the disbarment proceeding. The Supreme Court held:

> "They [such proceedings] become a trap when, after they are underway, the charges are amended on the basis of testimony of the accused. He can then be given no opportunity to expunge the earlier statements and start afresh." 390 U.S. at 551 (footnote omitted).

The Report and Charges disagree on whether mere access or actual abuse of inside information, or neither of these is the basis of Charge 1 (pp. 5-6, <u>supra</u>). At the hearing before the Panel, the Exchange several times changed its position as to whether Crimmins stood accused of use, possession or mere access to inside information; compare Tr. 284 with Tr. 448-65. In effect, the Exchange's counsel answered the access, possession or use questions with either "yes", "no" or "I stand on the charges as stated." (<u>Id</u>.)

If access to inside information alone, without abuse thereof, prohibits solicitation, a proposition greatly

in doubt (see _SEC_ v. _Lum's Inc._, 365 F. Supp. 1046, 1065 (S.D.N.Y. 1973)) then Crimmins was entitled to know that this was the Exchange's claim, without being misled with a charge that he had and abused inside information. Moreover, the Panel chairman appeared to recognize that mere access is not improper even when coupled with solicitation, when he said "there is nothing per se illegal at all" with maintaining a close relationship with a company while being active in its stock (Tr. 276). Indeed, there was no written statute, rule, regulation or policy statement prohibiting the conduct found to violate Charge 1 prior to the events in question. See Point III, _infra_. No sooner did Crimmins believe that he had finally understood Charge 1 than he was faced with the problem that it did not charge illegal conduct!

At times, the Exchange construed Charge 1 to allege that it is improper for a registered representative who owns restricted (and hence lower-priced) stock in a company, to recommend stock of that company to customers, presumably because his recommendations might be motivated by self-interest. So stated, Charge 1 has nothing to do with inside information. At several points, the hearing appeared to be progressing on this theory (Tr. 125, 129-31, 242-45, 276-77), instead of a charge involving inside information (Tr. 284-85). <u>The Exchange then reversed itself and stated that the Crimmins' private FSN stock purchase was not the basis</u>

of Charge 1, although "it could be" (Tr. 288-89). From this, the proceeding drifted to a charge that Crimmins had actually been bribed to solicit customers for FSN stock (Tr. 396, 423-24, 484-85) only to have a charge of abuse of inside information resurface (Tr. 448-464, 507-08, 545-47). In the latter instance the Exchange also charged that Crimmins participated in stock price manipulation by FSN insiders.

It appeared that even the Panel did not know which of these charges was the "real" Charge 1. When Crimmins' counsel objected that he couldn't determine what in Charge 1 was alleged to be wrongful conduct (Tr. 276), the Panel chairman asked the Exchange's counsel to "help the Panel in that regard" by explaining what Charge 1 alleged (Tr. 276). At the end of 25 pages of colloquy Crimmins' position was stated by his counsel:

> "... We are going ahead to a certain extent blindly. I think that the discussion before the recess indicates we have to go ahead blindly with the defense, but we have no choice...." (Tr. 301)

The Panel was unable to decide what Crimmins did wrong; its Determination concludes that Crimmins was under an obligation "to avoid actual or potential conflicts of interest"* (130a).

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* The harshness of the Exchange's penalty is inconsistent with the "non avoidance of a potential" conflict of interest (see Point VI, *infra*).

Due Process is not a shell game in which the accused is required to find the real charge before he is permitted to engage in a defense on the merits. The record amply illustrates that the Exchange's unwillingness to define and specify its basis for Charge 1 resulted in Crimmins' inability to prepare for or defend against the Charges. As in Jaffee, supra, 446 F.2d at 394 he might have been able to argue against the prosecution's theory or to direct his resources in that direction if he knew what that theory was.*

Denial of Discovery

The Interrogatories (99a-114a) Crimmins submitted to the Exchange prior to the hearing were designed to clarify the Charges, but the Exchange refused to submit any answers. This discovery was necessary as a matter of due process because Crimmins could not otherwise know what the basis for Charge 1 was.

As this Court held in Sloan v. New York Stock Exchange, Inc., 489 F.2d 1 (2d Cir. 1973), there is no good reason for denying discovery in an administrative proceeding where it is otherwise unavailable. See also 1 K. Davis, Administrative Law, Ch. 8, § 8.15, p. 589 (1958). Discovery is particularly important where notice has been

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* For example, if he knew which of the conduct alleged was considered improper and why, he might have been able to present expert testimony that the conduct charged was perfectly proper, as he did with respect to Charge 3 (Tr. 316-17).

inadequate. The Supreme Court has explained the close connection between notice and discovery:

> "... [S]implified 'notice pleading' is made possible by the liberal opportunity for discovery and the other pretrial procedures established by the [Federal] Rules to disclose more precisely the basis of both claim and defense and to define more narrowly the disputed facts and issues." (footnote omitted) Conley v. Gibson, 355 U.S. 41, 47-48 (1957).

Had the Exchange supplied answers to Crimmins' Interrogatories, its defective notice might have been cured. Its failure to do so constitutes an independent violation of due process.

New Charges Raised at the Hearing

At the hearing, for the first time in the Exchange's proceedings against Crimmins, the Exchange raised six new charges described below. Crimmins had not previously been informed that these matters would be heard.*

(1) There is no issue in Charge 1 of Crimmins' disclosure to customers of his FSN purchases; yet the Panel permitted questions on that issue by the Exchange (Tr. 342-43), over Crimmins' objections (Tr. 342-43). The

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* One of these matters, Crimmins' purchases of restricted FSN stock from members of FSN management, had been referred to in the Charges as an element in the so-called "special relationship" existing between Walston and FSN but there was no charge until the hearing (Tr. 242-43, 526-29, see also Tr. 125, 129-31) that these purchases were intrinsically improper. See Affidavit of Exchange's counsel, ¶ 20 (159a) and p. 21, infra.

Panel chairman himself cross-examined Crimmins on whether he had made proper disclosures to his customers (Tr. 517-18).* To Crimmins' prejudice, the Panel held that Crimmins had breached a duty of disclosure to his customers (130a). As in Re Ruffalo, supra, the proceedings became "a trap ... after they ... [were] underway, the charges ... [were] amended on the basis of the testimony of the accused." 390 U.S. at 551.

(2) There were so many allegations which were undefended (because they were new), the Panel was convinced of Crimmins' culpability on the actual charges. This is evidenced by the Panel's own accusatory questions about charges not in the Exchange's notice. Thus, although two high Walston officials had testified that Crimmins' private purchase of FSN stock needed no clearance and was perfectly proper (Tr. 285-86, 317, 333, 336), a panel member expressed his extreme disapproval (Tr. 526-28), saying "I can't imagine doing it without clearing it with my firm"** (Tr. 526) and calling the testimony of the Walston officials "the most extraordinary testimony I have seen in my experience"

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* Actually, Crimmins' testimony on this issue is inconclusive. He made the relevant disclosures to "some" customers (Tr. 517-18). There was no evidence on whether those to whom no such disclosures were made were unsolicited FSN purchasers, and therefore, not required to be advised.

** The prejudice of having a Panel member testify against an accused is self-evident.

(Tr. 528). This occurred despite the fact that no issue of disclosure to Walston is alleged in the Exchange's notice. The Panel began to treat Charge 1 as involving an issue of disclosure to Walston because the Exchange's counsel had succeeded in introducing that issue over Crimmins' objection (Tr. 384-88).

(3) The Charges do not allege that it was intrinsically and independently improper for Crimmins to purchase FSN stock from FSN officers, and Crimmins' counsel objected to such an amendment of the Charges (Tr. 243). Nevertheless, the Panel chairman asked:

> "... Mr. Crimmins, did it ever occur to you when you did determine that there was a possibility or in fact that these 10,000 shares of stock could be purchased at a discount as investment letter stock, that you owed an obligation, as a partner [Mr. Crimmins was not a partner] and employee, to make available that transaction to Walston and your fellow partners,* or indeed make it available to one of your public customers, because you, as a professional, deemed it to be an advantageous purchase?" (Tr. 528-29)

(4) The Exchange, over objection (Tr. 422), introduced testimony regarding transactions in stocks having nothing to do with FSN or the Charges (Tr. 421-24), and

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* Mr. Crimmins is here, apparently, charged with personally taking a corporate opportunity of his employer Walston, or personally depriving other stockholders of Walston of an investment opportunity. Neither of these charges appear in the notice and as to both, Walston officials testified Crimmins had no obligation to advise Walston of his purchases. See p. 25, <u>infra</u>.

(5) raised a charge that Crimmins was "singled out as a beneficiary" (Tr. 423) by FSN insiders, i.e., that he was bribed. Indeed, the Exchange's counsel began this line of questioning with the admission "It has nothing to do with the Charges." (Tr. 421).

The bribe charge was not lost on the Panel. Although it was not within the Charges, a Panel member plainly accused Crimmins of taking a bribe when he said:

> "You are asking us to believe that for a consideration, in effect, of a discount amounting to a couple of hundred thousand dollars, you have done nothing and they needed nothing?" (Tr. 519-20)

The persons referred to as "they" in the quoted portion, who sold FSN stock to Crimmins, were indicted on and plead guilty to charges growing out of the FSN debacle, United States v. Jack L. Clark, 72 Cr. 1356,(S.D.N.Y. 1972). The record of that and the subsequent proceedings showed that their motivation in selling all the FSN stock they could was to ensure their personal fortunes by liquidating their large holdings of FSN stock before its collapse.* Crimmins, like other public investors, was the victim of the fraud perpetrated by these FSN people. His entire

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* The Exchange's Report indicates that these FSN insiders were liquidating their FSN stock holdings partially through numbered accounts maintained in Walston's Chicago office (53a-55a).

$405,000 investment in restricted FSN stock was lost (Tr. 311). Despite this, the Exchange's counsel made it appear that Crimmins had himself been indicted (Tr. 522).*

(6) The Exchange again digressed from the stated Charges over Crimmins' objection (Tr. 427-29), when it brought up a then pending charge by the NASD that Crimmins had improperly allocated FSN stock in a public distribution being underwritten by Walston (Tr. 427-30). The prejudice was not merely related to the lack of notice but also to the fact that the NASD charge was so meritless it was withdrawn without a hearing shortly after the Panel issued its Decision. District Conduct Committee For District No. 12 v. Walston & Co., Inc., NASD District No. 12, No. NY-1688 (Jan. 16, 1974).

In Vitarelli v. Seaton, 359 U.S. 535, 541-42 (1959), the Supreme Court held, relying on administrative law rather than on constitutional law, that the Department of Interior had denied a discharged employee proper notice and a meaningful hearing when, at a hearing called to consider his suspension, the employee was questioned concerning matters "nowhere mentioned in the statement of charges" and there were no "reasonable restrictions" as to "relevancy, competency and materiality of matters considered." The

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* He was named as a "co-conspirator", but not "indicted"; this does not mean there was any evidence found that Crimmins was guilty of wrongdoing, Lyman v. Standard Brands, Inc., 1973 CCH Fed. Sec. L. Rep. ¶ 94,153 (S.D.N.Y. Aug. 23, 1973).

latter requirements were held to be "indispensable indicia" of a meaningful hearing, *Id*. As shown above, the Exchange refused to be bound by these "indispensable indicia."

The departures by the Exchange from the charges in its notice, and its introduction of new charges, were over the strenuous objections by counsel. Crimmins could have presented well prepared, organized and meritorious defenses to each of them if he had fair notice that they would be issues. By its flagrant abuse of the fair notice and fair hearing requirements, the Exchange has violated due process and should be enjoined from enforcing its Determination under the facts of this case.

III

<u>THE STANDARD OF CONDUCT UTILIZED BY THE PANEL IN IMPOSING A PENALTY UNDER CHARGE 1 WAS UNCONSTITUTIONALLY VAGUE AS APPLIED TO THE FACTS OF THIS CASE.</u>

The record demonstrates, without contradiction, that the conduct alleged to be wrongful in Charge 1 was considered perfectly proper by Crimmins' superiors at the time it occurred, and Crimmins relied on their approval (115a-125a; Tr. 285-86, 316-18, 333). All the conduct alleged to be wrongful in Charge 1 was brought to Walston's attention by the Exchange in a letter dated June 17, 1969 (115a-117a) and in an Exchange interview of Crimmins on November 25, 1969 (testimony quoted at Tr. 473-76). Walston's president, William D. Fleming, in a reply letter dated June 30, 1969, strongly approved the conduct described in the June 17th letter (120a). Walston's house counsel approved the conduct described in the November 25, 1969 testimony (the restricted FSN stock purchases) (Tr. 285-86) and, at the hearing, Mr. Rauschman, Walston's compliance officer at the time in question, testified that there was nothing wrong with such conduct (Tr. 317-18).

Indeed, the Exchange fully accepted Mr. Fleming's defense of Crimmins. Responding to Mr. Fleming's letter on August 20, 1969, the Exchange lamely admitted "there may be

a misunderstanding", and hastened to assure Mr. Fleming that its concern was for the future alone and not for the prior acts of Walston personnel, including Crimmins, which now form the basis of Charge 1:

> "The Exchange does not intend to imply that there is any impropriety in the existence of a close relationship between your firm and Four Seasons. Its concern is rather with the absence of proper controls, in view of this relationship ..." (123a)*

Such approval, of course, was proper under the state of the law five years ago, as recently recognized in SEC v. Lum's, Inc., supra. Speaking of "the problem of [brokerage company] employee contacts with management" of the companies whose stock was traded, the Court recognized that such conduct was not prohibited at the time it occurred, six months after the exchange of letters discussed above:

> "... I am unwilling to impose hindsight liability solely based on the absence of any rule prohibiting such relationships. In January, 1970, Rule 10b-5 had not evolved to its present status; ... moreover, Lehman has simply not 'focused' on the problem of employee contacts with management. Nor, for that matter, had any other broker-dealer or regulatory agency.... This 'lack of focus' is clearly comprehensible in what was and is a murky area of the law." (365 F. Supp. at 1065; emphasis added.**

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* See also Tr. 576-77, 583-85 for evidence of other approval of Crimmins' conduct.

** As late as April 30, 1971, Walston continued to deny that there was any prohibition against the so-called "special relationship", in a response prepared by counsel (81a-82a).

Upon these facts, and in the "murky area of the law" described in _SEC_ v. _Lum's, Inc._, _supra_, the Panel found Crimmins guilty of "conduct or proceeding inconsistent with just and equitable principles of trade" (129a). The District Court found that the quoted standard "as applied to plaintiff, ... is not impermissibly vague" (177a). This finding is erroneous as a matter of law.

A standard is unconstitutionally vague, and thereby violative of due process, when it:

> "... forbids ... the doing of an act in terms so vague that men of common intelligence must necessarily guess at its meaning and _differ as to its application_ ...". _Connally_ v. _General Construction Co._, 269 U.S. 385, 391 (1926; emphasis added.)*

The Supreme Court applied due process requirements to matters of disciplinary proceedings in _Re Ruffalo_, _supra_. Reaching the question of the vagueness of the court rule involved, and urging (as Crimmins does here) that the standard involved was vague only as applied to the facts of the case, Mr. Justice White's concurrence in _Ruffalo_ cogently states the vagueness issue presented by this Appeal:

> "Even when a disbarment statute is as unspecific as the one before us, members of a bar can be assumed to know that

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* _Connally_ also applies when civil penalties are imposed. _Giaccio_ v. _Pennsylvania_, 382 U.S. 399 (1966).

> certain kinds of conduct, generally condemned by responsible men, will be grounds for disbarment. This class of conduct ... includes conduct which all responsible attorneys would recognize as improper for a member of the profession.
>
> * * *
>
> "The appraisal of petitioner's conduct is one about which reasonable men differ, not one immediately apparent to any scrupulous citizen who confronts the question [footnote omitted]. I would hold that a federal court may not deprive an attorney of the opportunity to practice his profession on the basis of a determination after the fact that conduct is unethical if reasonable attorneys would differ in appraising the propriety of that conduct." Re Ruffalo, supra, 390 U.S. at 555-556 (White, J., concurring; emphasis added).

The difference of reasonable men employed in a profession over the application of a standard purporting to regulate their professional conduct is sufficient evidence, in and of itself, of the unconstitutional vagueness of the standard. United States v. Cohen Grocery Co., 255 U.S. 81 (1921), and nine related cases reported at 255 U.S. 98-109. Put differently, the fact that those within the profession "differ as to its application" renders the standard unconstitutionally vague. Connally v. General Construction Co., supra, 269 U.S. at 391.

As demonstrated above, Crimmins received advice from his employer and its counsel, reasonable men in the

profession, that his conduct was not "inconsistent with just and equitable principles of trade" (81a-82a, 115a-125a; Tr. 285-86, 576-77, 583-85). Accordingly, a finding of guilt under Charge 1 necessarily disregards: (a) all record evidence of advice given to Crimmins that his conduct was within the applicable standard, and (b) the unsettled state of the law at the time the conduct occurred regarding the application of the standard, SEC v. Lum's, Inc., supra.

The rule-making requirement of § 6(b) of the 1934 Act, 15 U.S.C. § 78e(b), itself recognizes that the standard of "conduct ... inconsistent with just and equitable principles of trade", which it enacts, must be defined before punishment can be imposed for violation of the standard. Baird v. Franklin, 141 F.2d 238, 243-44 (2d Cir. 1944; separate opinion of Judge Clark concurring as to this point), cert. denied, 323 U.S. 737 (1944); Pettit v. American Stock Exchange, 217 F. Supp. 21, 29 (S.D.N.Y. 1963; Judge Clark's concurrence in Baird followed).

Exchange Rule 345(a)(4), 2 CCH American Stock Exchange Guide ¶ 9395, under which Charge 1 was brought (91a), merely repeats the standard contained in § 6(b) of the 1934 Act instead of defining it and offering a guide for its construction. Thus the vagueness which § 6(b) of the 1934 Act recognized to be inherent therein is demonstrably uncured.

As Mr. Justice White recognized, however, an otherwise vague standard regulating professional conduct may be saved when applied to conduct "which all responsible [professionals] would recognize as improper for a member of the profession." Re Ruffalo, supra, 390 U.S. at 555. Thus, the vagueness question would not have been presented in this case if the Panel and the District Court had considered the evidence of the professional opinions rendered to Crimmins at the time his conduct occurred. Upon that body of professional knowledge, which Crimmins consulted and upon which he relied, the otherwise vague standard was savingly defined and applied to his conduct: his professional peers judged it and approved it.* By disregarding this evidence, the Panel imposed punishment under an undefined standard which was thereby unconstitutionally vague, and the District Court's approval of the Panel's decision was erroneous as a matter of law.

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* This approval was consistent throughout the brokerage business. SEC v. Lum's, Inc., supra.

IV

THE EXCHANGE VIOLATED DUE PROCESS BY IMPOSING A PENALTY BASED ON A FINDING, NOT SUPPORTED IN THE RECORD, THAT CRIMMINS HAD MADE A "MISSTATEMENT ABOUT A MATERIAL POINT".

Charge 2 alleged that on November 25, 1969 Crimmins made "a misstatement about a material point" to the Exchange staff as to the extent of his indebtedness on his purchases of restricted FSN stock (Tr. 474-76). Crimmins gave the Exchange the "material" fact, i.e., that he was substantially indebted to officers of FSN, and the fact that he inadvertently gave the wrong amount of the indebtedness was not material, intentional or the proper basis for a penalty.

The Exchange had called Crimmins for an interview on short notice, without advice as to the areas to be covered. He did not bring any records and was examined for a full day by four Exchange staff members (Tr. 478-79). Crimmins' testimony on November 25, 1969 shows that he did not know offhand the specific amount of his indebtedness.

> "'Question: Do you happen to know what the total amount of the indebtedness is? Answer: No, but I can check it for you.'" (Tr. 475-76) (emphasis added).

Crimmins submitted the documentation underlying his purchases, and containing the required information, within seven days of his Exchange interview (Tr. 476).

Thus, the error made in the specific amount of the indebtedness was voluntarily corrected by Crimmins within seven days.

The Exchange's imposition of a penalty based on a finding unsupported by the record violates due process, I.C.C. v. Union Pacific R.R., 222 U.S. 541, 547 (1912).

V

AS A MATTER OF LAW THERE WAS NO VIOLATION OF REGULATION T.

As a matter of law Crimmins did not violate Regulation T, 12 C.F.R. § 220.7(a) ("Reg. T") in his purchase of restricted FSN stock. The transactions which resulted in Charge 3 are described at pp. 12-13 of the District Court's Opinion (180a-181a).

Reg. T provides, in part:

> "A creditor may arrange for the extension or maintenance of credit to or for any customer of such creditor by any person upon the same terms and conditions as those upon which the creditor, under the provisions of this Part, may himself extend or maintain such credit to such customer, but only upon such terms and conditions...." (emphasis added).*

The Panel stated no reason for finding a violation (131a) but the District Court sustained the finding on

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* Relevant portions of Reg. T are annexed hereto.

the grounds that Crimmins was a "broker" as defined by § 3(a)(4) of the 1934 Act, 15 U.S.C. § 78c(a)(4), and hence a "creditor" as defined by Reg. T, 12 C.F.R. § 220.2(b). (Opinion, 181a-182a). The Court held that Crimmins was also his own "customer" as defined by § 220.2(c)(182a) and that he had "arranged" for credit to himself (184a).

It is of critical importance that the purchases in question were made without the use of any Walston facility or account and arranged and executed between two private persons acting as such. Walston did not know about the transaction (R. 552) nor did its rules require its knowledge or consent (Tr. 482-83). Walston's then Director of Compliance, testified that for this reason Reg. T was inapplicable and he would have so advised Crimmins if asked (Tr. 317, 337).

A. Crimmins Was Not A "Creditor"

"Creditor" is defined by § 220.2(b) as "any broker or dealer including any member of a national securities exchange." Crimmins was not a "broker", contrary to the holding of the District Court (181a-182a), and therefore he was not a "creditor" and was not subject to Reg. T. Sutro Bros. & Co., 41 SEC 443 (1963).

(1) Sutro held that salesmen of broker-dealers cannot themselves violate Reg. T because they are not themselves brokers.*

Before holding a salesman liable in Sutro, the SEC was careful to note that it did so only on an aiding and abetting theory and only because the salesman used a firm account. 41 SEC at 451.

> "We are not dealing here with the situation of a salesman who executes no securities transactions for himself through his firm, but in a completely separate context arranges to borrow money from a factor." Id. at 451, n. 16 (emphasis added).

(2) Section 3(a)(4) of the 1934 Act makes "brokers" only of those "engaged in the business of effecting transactions in securities for the account of others" (emphasis added). Crimmins' business was obtaining purchase and sale orders to be effected by his employer, Walston, who was in the business of effecting transactions and was therefore a "broker". As stated in E. Weiss, Registration and Regulation of Brokers and Dealers (1965), "...a person is not a broker or dealer if his securities activities are performed on behalf of and are in fact under the complete and effective control and supervision of a broker or dealer." Id. at 8.

* Under Sutro, salesmen for broker-dealers can only be guilty of aiding and abetting their employer's violation, 41 SEC 453, 458, but there was no aiding and abetting charge here against Crimmins and Walston was never held or accused of being, nor indeed could it be, in violation of Reg. T.

(3) If a salesman were a "broker" he would be required to comply with all the statutory obligations of "brokers". "Brokers" must register with the SEC before "effecting" any transaction off an exchange, they must meet SEC capital requirements, 1934 Act, §§ 15(a), (c), 15 U.S.C. § 78o(a), (c), and they must comply with the record-keeping requirements under § 17(a) of the 1934 Act, 15 U.S.C. § 78n(a). These practices have never been required of salesmen by the SEC. The District Court's holding would even oblige salesmen to personally contribute to the Securities Investor Protection Corporation, 15 U.S.C. § 78 ddd(c).

(4) In support of its position, the Exchange submitted only an opinion letter of <u>a staff member</u> of the Board of Governors of the Federal Reserve System ("FRB") (126a-128a) which concluded that an officer of a brokerage corporation could be in violation of Reg. T when purchasing for himself outside of a firm account, provided one of two assumptions could be made*:

> (i) That an officer of a broker-dealer who <u>might be</u> a partner <u>if</u> his firm were a partnership may be considered a "creditor".

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* Moreover, this opinion indicates on its face that it is the result of oral conversations with staff members of the Exchange. Crimmins had no opportunity to cross examine the staff members.

This assumption is invalid because: as a matter of law, an officer is not the equivalent of a partner, particularly under the 1934 Act, Popkin v. Dingman, 366 F. Supp. 534 (S.D.N.Y. 1973); the basis for a partner's status as a "creditor" is the specific inclusion of "a partner" in § 3(a)(3) of the 1934 Act, a definition adopted by Reg. T in 12 C.F.R. § 270.2(a) and no such basis exists for inclusion of a corporate officer.

Crimmins was a 1% shareholder, a branch manager and a low level vice president of Walston, holding no policy or rule-making authority at Walston (see p. 3, supra). There is no basis in the record for assuming that Crimmins would have been a partner if Walston were a partnership; Walston's Director of Compliance indicated the contrary conclusion (Tr. 317, 337).

> (ii) That in making the purchase, the officer acted as representative of his firm (127a) and hence aided and abetted his firm's violation; an assumption based, in turn, on the assumption that the brokerage firm "consented to the acts of its officer" (126a).

This assumption is invalid because no aiding and abetting charges were made in this case and Sutro, supra, establishes that Walston did not violate Reg. T. Crimmins was not acting as Walston's representative in purchasing for himself (Tr. 482-83), the Exchange admitted that Walston was unaware of the purchases (Tr. 552) and this admission

refutes the assumption that Walston "consented" to the transaction.

Thus, both the SEC in <u>Sutro</u> and the FRB in its staff member's letter do not attempt to assert Reg. T violations on the premise that a salesman is a "broker" and therefore a "creditor." Only the District Court attempted that assertion and it did so without legal authority.

It was never charged that Crimmins was a "dealer" and under § 3(a)(5) of the 1934 Act, a person is not a "dealer" if he buys or sells securities for his own account "not as a part of his regular business". Neither the Exchange Panel nor the District Court concluded that Crimmins was a "dealer" for Reg. T purposes. Crimmins' only "regular business" was acting as a salesman and branch manager for Walston and in this capacity, he is not a "dealer", <u>E. Weiss</u>, <u>supra</u>, at 8; <u>Wallach</u> v. <u>SEC</u>, 202 F.2d 462 (D.C. Cir. 1953).

Crimmins is not a "broker-dealer" or "member" within the statutory definition, and therefore, is not a "creditor" within the meaning of Reg. T.

B. <u>Crimmins Was Not A "Customer"</u>

Crimmins' purchase transactions were not effected through any Walston account or by the use of any

Walston facility (Tr. 317, 482-83, 552). Therefore, Crimmins was not a "customer", of Walston. Sutro, supra at 451. The District Court's analysis under which Crimmins was simultaneously both "broker" and his own "customer" is too solipsistic to be valid. It is not supported by the law, the record or logic.

C. The FSN Purchases Were Not Within Reg. T Purposes

The FRB has ruled that a transaction within the technical terms of Reg. T does not violate that regulation if it is not the kind which the margin requirements were intended to regulate. 12 C.F.R. § 220.119 (1962).

Reg. T was issued "[F]or the purpose of preventing the excessive use of credit for the purchase or carrying of securities." 1934 Act § 7(a), 15 U.S.C. § 78g(a). Its main purpose is reduction of aggregate national credit invested in speculation in securities and its by-product is protection of the small speculator who spreads himself too thin. Remar v. Clayton Securities Corp., 81 F. Supp. 1014, 1017 (D. Mass. 1949). The regulation also protects against stock market fluctuations caused by the "exquisite liquidity" which develops when borrowed money is in the stock market. SEC Special Study of Securities Markets, Pt. 4, Ch. X, p. 2 (1963), quoting from comments by Thomas G.

Corcoran in Hearings before Senate Committee on Borrowing and Currency, p. 15, 73rd Cong., 1st Sess., p. 6494 (1934).

None of these purposes applies here because Crimmins was not "the small speculator" referred to in Remar, supra, but rather a member of the securities business with some 15 years of experience. There was no "exquisite liquidity" problem since the restricted securities involved here were practically unsaleable for at least three years; see Diagnostic Research, Inc., '70-'71 CCH Fed. Sec. L. Rep. ¶ 77,987 (1971), and were not a part of the securities market.

Since the two FSN purchases involved here were not within Reg. T purposes, they were not in violation of Reg. T. 12 C.F.R. § 220.119.

There is no basis in law for finding a violation of Reg. T under the circumstances of this case and the District Court should be reversed.

VI

THE EXCHANGE VIOLATED DUE PROCESS BY IMPOSING AN UNREASONABLY SEVERE AND PUNITIVE PENALTY UNDER THE FACTS OF THIS CASE WITHOUT ANY FINDING OR EVIDENCE THAT SUCH A PENALTY WAS REQUIRED BY THE PUBLIC INTEREST.

A. Exchange Penalties Must Be Remedial, Not Punitive

The Exchange is subject to the constraints of the 1934 Act in levying penalties in disciplinary proceedings, brought under the self-regulatory powers conferred by §§ 6(b) and (d) of the 1934 Act, 15 U.S.C. § 78f (b), (d), Crimmins v. American Stock Exchange, Inc., supra, 346 F. Supp. 1256 at 1259.

The courts and the SEC have held that "administrative proceedings under the Securities Exchange Act are not penal, they are remedial." Beck v. SEC, 413 F.2d 832 (6th Cir. 1969) (remanding to SEC); 430 F.2d 673 (1970) (reversing SEC after remand); A.J. White & Co., SEC 1934 Act Rel. No. 10645, n. 7 (Feb. 15, 1974). The 1934 Act requires that SEC penalties be "in the public interest," (§ 15(a)(5), applying to SEC proceedings) and that NASD penalties not "having due regard to the public interest" shall be cancelled, reduced or remitted (§ 15(h)(2)).

In Beck, the court agreed that there was "substantial evidence" to support the SEC's finding of guilt

but the case was remanded because the SEC failed to disclose why the public interest necessitated a four-month suspension despite the fact that the plaintiff performed responsibly for six years after the violation.

Quoting from SEC v. Chenery Corp., 318 U.S. 80, 94 (1943), the Court said:

> "'The Commission's action cannot be upheld merely because findings might have been made and considerations disclosed which would justify its order as an appropriate safeguard for the interests protected by the Act. There must be such a responsible finding. * * * For the courts cannot exercise their duty of review unless they are advised of the considerations underlying the action under review.'" 413 F.2d 834.

On remand the SEC affirmed the penalty but stated its reasons as follows:

> "'We imposed the sanction on Beck with a view to adequately impressing upon him, through the impact of the sanction, the necessity of avoiding a repetition of his specific misconduct and the need for scrupulous propriety in all aspects of his securities activities in the future, as well as with a view to discouraging such misconduct by others in the securities industry.'" 430 F.2d 674.

The Court of Appeals held this to be a gross abuse of discretion because there was no evidence of subsequent wrongdoing by the plaintiff and no reason to believe that he would be inclined to further illegal or fraudulent acts. The penalty may be remedial but not punitive. 430 F.2d 675; Blaise D'Antonio & Assoc., Inc. v. SEC, 289 F.2d 276 (5th Cir. 1961).

B. The Exchange Made No Finding Of Necessity In The Public Interest To Support Its Penalty

The Panel Determination (129a-132a) fails to make the "responsible finding" required by SEC v. Chenery Corp., supra, and Beck v. SEC, supra. The Determination fails to discuss the penalty or to state why such a harsh penalty was necessary and fails to relate it to any public interest. There is no evidence or finding of subsequent wrongdoing* or of a likelihood of repetition, as required by Beck, supra. Although it is possible to speculate about the Panel's reasons, such speculation about the findings that "might have been made" cannot support the Panel's action. Beck, supra. The District Court did not relate the penalty to the public interest, instead deferring to the Panel's unexplained Determination.

C. The Penalty Is Unjustified By The Record

At most the Exchange proved the following at the hearing:

1. Crimmins breached a newly-proclaimed duty to avoid a potential conflict of interest by conduct blameless

* The conduct challenged occurred in 1969; the charges were served in November 1971; Crimmins remained as a registered representative of Walston until December 1972 when he resigned. There is no charge of wrongdoing at any time from 1969 until December 1972.

at the time of its occurrence, SEC v. Lum's, Inc., supra, (see p. 45, infra);

2. While testifying before the Exchange's staff in November 1969, Crimmins made an immaterial error which was fully, immediately and voluntarily corrected (see Point IV, supra); and

3. Crimmins may have violated Reg. T without intent to do so in transactions which did not harm the public or affect the securities market and which were approved by his superiors and were so apparently proper that the Exchange did not itself know whether they violated Reg. T (see Point V and p. 44, infra).

Upon this record, the penalty is simply unconscionable, as well as being "punitive" rather than "remedial".

(1) Crimmins' Actions were Disclosed, Supervised and Approved

The conduct alleged in Charge 1 was fully disclosed, approved and encouraged by plaintiff's superiors (115a-122a, Tr. 285-86) who were in constant communication with the Exchange. The Exchange acknowledged this supervision and approval (123a-124a).

Walston's Compliance Director (whose expertise was acknowledged by the Panel chairman, Tr. 315-16) testified that he would have approved the restricted stock

purchases as not in violation of Reg. T, if asked (Tr. 317). Walston's house counsel testified that there was no Walston obligation requiring Crimmins to ask (Tr. 285) and that there was nothing wrong with the transaction (Tr. 285-86). The Exchange was itself in doubt about Reg. T's applicability (Tr. 578-79). Crimmins should not be punished for reaching a conclusion endorsed by his superiors. Moreover, even Reg. T exempts good faith mechanical mistakes, 12 C.F.R. § 220.6(k).

Crimmins' full disclosure and reliance upon the advice of his superiors means that he could only be guilty of a mere technical violation and certainly not a willful violation. See Mayflower Securities Co., Inc. v. Bureau of Securities, Cal. No. A-51 (N.J., Dec. 4, 1973)*. Such a violation may not properly result in a suspension for any length of time. Id. at 14-15. "[T]he sanction of suspension is so severe a penalty" that it "should not be permitted to stand in the way of fair dealing and justice." Id. at 18.

(2) The Penalty Does Not Fit the Circumstances

(i) Law is "Murky"

The conduct alleged in Charge 1 was not punishable at the time it occurred. SEC v. Lum's, Inc., supra.

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* Opinion attached as appendix to Crimmins' Memorandum in Support of Reargument dated December 26, 1973.

> "Although the potential conflicts inherent in ... [the salesman's] relationship with Lum's are obvious, and, in hindsight unfortunate, I am unwilling to impose hindsight liability solely based on the absence of any rule prohibiting such relationships. In January, 1970, Rule 10b-5 had not evolved to its present status ... Lehman had simply not 'focused' on the problem of employee contacts with Management. Nor for that matter, had any other broker-dealer or regulatory agency.... This 'lack of focus' is clearly comprehensible in what was and is a murky area of the law." 365 F. Supp. 1065 (emphasis added).

As late as April 30, 1971, Walston was denying both the existence and impropriety of any "special relationship" (Walston Response, 81a-82a). Walston ultimately forebade such a relationship by sales personnel but not until November 22, 1971, two years after the events under consideration.* Crimmins, like Lehman in Lum's, should not be held punishable for helping maintain a relationship not considered improper at the time.**

(ii) Discriminatory treatment

The Report (5a-80a) which charged Crimmins, also charges Messrs. Nissan, Probert, Miller, McCollum and Ehlers with conduct like Crimmins' (23a, 26a, 30a-31a, 38a-39a, 41a-80a). However, Messrs. Nissan and Probert were

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* See Walston policy Memorandum described at p. 59, Crimmins Answer to Charges, Hill Affidavit, Ex. D.

** The Subcommittee on Broker-Dealer Matters of the American Bar Association has expressed its concern over the possibility that newly declared SEC guidelines will be given retroactive application. 1 SEC. Reg. Law Journ., No. 4, at 328, 351 (1974).

never formally charged or penalized by the Exchange. Mr. McCollum (but <u>not</u> Mr. Crimmins) was charged with misusing inside information (80a); McCollum was indicted and pleaded guilty to criminal fraud for his FSN conduct, but suspended by the Exchange for only 30 days. The same is true of Mr. Miller who, together with McCollum were Crimmins' superiors at Walston. Miller and McCollum were fined but not imprisoned. The President of Walston personally advised the Exchange in writing that he approved and encouraged Crimmins in his simultaneous solicitation and FSN management contacts (118a-122a), yet he and the others accused by the Report were never suspended by the Exchange for more than 30 days; Crimmins was not indicted but stands condemned to unemployment for nine months and to a <u>de facto</u> expulsion.*

In an Exchange proceeding reported in The Wall Street Journal, Nov. 13, 1973, p. 14**, a broker-dealer was censured and fined for anti-fraud violations. Two of its officers maintained a "special relationship" with a company while recommending its stock but neither was even charged with wrongdoing by the Exchange. In <u>Blyth</u>,

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* The Exchange actually imposed a permanent expulsion on Crimmins. By the simple expedient of disapproving his transfer of employment from one member firm to another, the Exchange has barred any Exchange transaction by Crimmins from December 1972 to the present. The Exchange took this action <u>before</u> the Determination was issued. See Affidavit of Frank J. Crimmins dated August 2, 1973.

** A companion SEC proceeding was also brought, see <u>SEC v. Topper Corp.</u>, 1973 CCH Fed. Sec. L. Rep. ¶ 94,209 (S.D.N.Y. Nov. 12, 1973).

Eastman, Dillon & Co., Inc., SEC 1934 Act Rel. Nos. 10565 and 10566 (Dec. 19, 1973), a salesman received a censure and a 15-day suspension for violations of the antifraud provisions of the securities laws through the maintenance by the salesman of an investment banking relationship with an issuer. In SEC v. Lum's, Inc., supra, no penalty was imposed for the maintenance of such a relationship.

In Matter of Lewnes, 1934 Act SEC Rel. No. 10501 (Nov. 15, 1973), a Reg. T violator was punished by a censure, temporary suspension from supervisory duties and a $1 fine. In a different proceeding a $2,500 fine was imposed for aiding and abetting a criminal violation of Reg. T, SEC Lit. Rel. No. 6173 (Dec. 12, 1973).

When the mitigating circumstances shown above are present in SEC proceedings, there is no public interest in imposing a penalty; Sutro Bros. & Co., 41 SEC 470, 482 (1963) (the salesman's conduct was approved by his supervisors); Vranken Investors Corp., SEC 1934 Act Rel. No. 7237 (1964) (broker-dealer acted in good faith); Brown, Barton & Engel, 40 SEC 1038, 1041 (1962) (salesman acted in reliance on the advice of counsel). In this case, the Exchange did not even consider Crimmins' reliance on counsel although such reliance must be considered; The Whitehall Corp., 38 SEC 259, 274 (1958).

The Exchange's penalty on Crimmins is markedly harsher than the penalties visited upon others involved in this and other similar proceedings.

D. The Penalty is Extreme

In Robert W. Stark, Jr., Inc. v. New York Stock Exchange, Inc., 346 F. Supp. 217 (S.D.N.Y.); aff'd, 446 F.2d 743 (2d Cir. 1972), the court said:

> "It is a matter of extreme obloquy for an individual person to be expelled as a NYSE member. Expulsion may affect adversely his standing in the community and credit rating and reputation. He shows irreparable damage. Such a severe penalty has not before been visited on a NYSE member in the absence of dishonesty, unfairness, insolvency or moral turpitude or gross negligence. While members subject themselves to jurisdiction of the body, it must exercise such powers fairly." 346 F. Supp. at 232 (emphasis added).

Mr. Crimmins acted at the behest of his employer and in compliance with its rules and instructions. Therefore there was no dishonesty, unfairness or moral turpitude on his part.

The District Court's statement that it should not undo the Exchange's action because "the penalty was determined by a panel of plaintiff's professional colleagues, better situated than this court to assess a fair penalty" (189a) is unsupported. On that ground the SEC would never reduce NASD penalties, yet it does (see p. 10, supra), and the SEC would not have asked Congress to give it review power over stock exchange disciplinary proceedings,

yet it did. See SEC Study of Unsafe and Unsound Practices of Brokers and Dealers, supra, p. 42.

As held in Silver v. New York Stock Exchange, Inc., supra:

> "The § 6(b) and § 6(d) duties taken together have the broadest implications in relation to the present problem...
>
> * * *
>
> "'some government oversight is warranted, indeed necessary, to insure that action in the name of self-regulation is neither discriminatory nor capricious.'" 373 U.S. at 353, 359 (emphasis added) (citation omitted).

The severe penalty imposed on Crimmins and on no other person in the Exchange's proceeding is discriminatory and capricious and its enforcement should be enjoined.

CONCLUSION

For the reasons stated above, the decision of the District Court should be reversed and summary judgment entered in favor of plaintiff.

Dated: April 15, 1974

Respectfully submitted,

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REGULATION T

12 C.F.R. § 220

(Extracts)

§ 220.1. Scope of part. This part is issued by the Board of Governors of the Federal Reserve System (hereinafter called the "Board") pursuant to the Securities Exchange Act of 1934 (called the "Act" in this part), particularly sections 7 and 8(a) thereof (15 U.S.C. 78g, 78h(a), as amended), and applies to every broker or dealer, including every member of a national securities exchange.

§ 220.2(a). The terms herein have the meanings given them in section 3(a) of the Act (15 U.S.C. 78c(a)).

§ 220.2(b). The term "creditor" means any broker or dealer including every member of a national securities exchange.

§ 220.2(c).* The term "customer" (1) includes any person, or any group of persons acting jointly, (i) to or for whom a creditor is extending, arranging, or

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* § 220.2(c) was amended July 8, 1969 "to provide that a person to or for whom a creditor is arranging credit is a 'customer' of the creditor, and to clarify that the term customer includes, but is not limited to, the type of persons enumerated therein." 1966-73 Fed. Bank. L. Rep. ¶ 95,143 at 80,137.

maintaining any credit or (ii) who in accordance with the ordinary usage of the trade, would be considered a customer of the creditor, and (2) includes, but is not limited to (i) in case the creditor is a firm, any partner in the firm who would be considered a customer of the firm if he were not a partner, and (ii) any joint venture in which a creditor participates and which would be considered a customer of the creditor if the creditor were not a participant.

<u>§ 220.6(k)</u>. <u>Innocent mistakes</u>. If any failure to comply with this Part results from a mechanical mistake made in good faith in executing a transaction, recording, determining, or calculating any loan, balance, market price or loan value, or other similar mechanical mistake, the creditor shall not be deemed guilty of a violation of this part if promptly after the discovery of such mistake he takes whatever action may be practicable in the circumstances to remedy such mistake.

<u>§ 220.7(a)</u>. <u>Arranging for loans by others</u>. A creditor may arrange for the extension or maintenance of credit to or for any customer of such creditor by any person upon the same terms and conditions as those upon

which the creditor, under the provisions of this part, may himself extend or maintain such credit to such customer, but only upon such terms and conditions, except that this limitation shall not apply with respect to the arranging by a creditor for a bank subject to Part 221 of this chapter (Regulation U) to extend or maintain credit on margin securities or exempted securities.